

ANALYSIS OF AMENDED BILL

Author: Alarcon Analyst: Jeani Brent Bill Number: SB 511
Related Bills: None Telephone: 845-3410 Amended Date: 05/10/1999
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Enterprise Zone Designation/Increases the Maximum Number of Zones to 75

SUMMARY OF BILL

Under the Government Code, this bill would increase the number of enterprise zones that may be designated from 39 to 75.

SUMMARY OF AMENDMENT

The May 10, 1999, amendments removed the bill's provisions that would have made various modifications to the rules regarding expansion of enterprise zones and replaced them with the provisions discussed in this analysis.

EFFECTIVE DATE

This bill would become effective January 1, 2000.

PROGRAM HISTORY/BACKGROUND

California has four types of economic development areas that have similar tax incentives:

- Enterprise Zones,
- Local Agency Military Base Recovery Areas (LAMBRA),
- Targeted Tax Area (TTA), and
- Manufacturing Enhancement Areas (MEA)

The following table shows the incentives available to each of the economic development areas.

Types of Incentives	EZ	LAMBRA	TTA	MEA
Sales or Use Tax Credit	X	X	X	
Hiring Credit	X	X	X	X
Employee Wage Credit	X			
Business Expense Deduction	X	X	X	
Net Interest Deduction	X			
Net Operating Loss	X	X	X	

SPECIFIC FINDINGS

Under the Government Code, existing state law allows the governing body of a city or county to apply for designation as an enterprise zone. Using specified criteria, the Trade and Commerce Agency (TCA) designates enterprise zones from the applications received from the governing bodies. Enterprise zones are designated for 15 years (except enterprise zones meeting certain criteria may be extended to 20 years), and TCA has designated each of the 39 enterprise zones

Board Position:

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Department Director

Date

Gerald Goldberg

7/6/1999

authorized under existing law. When an enterprise zone expires, TCA is authorized to designate another in its place (or redesignate the existing zone) to maintain a total of 39 enterprise zones. TCA may approve the geographic expansion of enterprise zones up to 15% in size and, for certain small enterprise zones, up to 20% in size.

TCA may audit enterprise zone programs and determine a result of superior, pass, or fail, and may dedesignate failing programs. Any business located in a dedesignated zone that has elected to avail itself of any state tax incentive for any taxable or income year prior to dedesignation may continue to avail itself of those tax incentives for a period equal to the remaining life of the enterprise zone, provided the business otherwise is still eligible for those incentives. Once an enterprise zone is dedesignated, TCA may designate another enterprise zone in its place to maintain a total of 39 enterprise zones, even though taxpayers in the dedesignated zone may continue to use the tax incentives that the taxpayers qualified for prior to dedesignation.

Under the Revenue and Taxation Code, existing state law provides special tax incentives for taxpayers conducting business activities within an enterprise zone. These incentives include a sales or use tax credit, hiring credit, business expense deduction, special net operating loss treatment, and net interest deduction. In addition, a wage credit may be claimed by specified employees of businesses operating within an enterprise zone. See attachment A for a detailed discussion of each tax incentive.

This bill would increase the total number of enterprise zones that may be designated at any one time from 39 to 75.

Implementation Considerations

Implementing this bill would occur during the department's normal annual update.

FISCAL IMPACT

Departmental Costs

This bill would not significantly impact the department's costs.

Tax Revenue Estimate

The revenue loss from this bill is estimated as follows:

Estimated Revenue Impact of SB 511 As Amended May 10, 1999 (in millions)					
Designated Zones	2000-1	2001-2	2002-3	2003-4	2004-5
Year 2000 - First 12 Zones	-\$3	-\$6	-\$12	-\$12	-\$12
Year 2001 - Next 12 Zones		-\$3	-\$6	-\$12	-\$12
Year 2002 - Last 12 Zones			-\$3	-\$6	-\$12
Total Revenue Loss	-\$3	-\$9	-\$21	-\$30	-\$36

Revenue Estimate Discussion

Based on information obtained from TCA, approximately 12 new enterprise zones would be designated each year over a three-year period. Currently the average state revenue loss for existing enterprise zones is \$1 million per zone per year, typically reached after a one to two-year start-up period. The revenue estimate shown above was obtained by multiplying the first-year negligible impact per zone (\$250,000), the second-year minor impact per zone (\$500,000) and the third-year impact (\$1 million) times the twelve zones that would be designated each year.

BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, as introduced February 18, 1999. The Franchise Tax Board's position for the bill as amended May 10, 1999, is pending.

Attachment A
SB 511
As Amended May 10, 1999

ENTERPRISE ZONE TAX INCENTIVES

Sales or Use Tax Credit

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified machinery purchased for exclusive use in an enterprise zone. The amount of the credit is limited to the tax attributable to enterprise zone income. Qualified property is defined as follows:

- Machinery and machinery parts used for:
 - manufacturing, processing, assembling, or fabricating;
 - producing renewable energy resources; or
 - air or water pollution control mechanisms.
- Data processing and communication equipment.
- Certain motion picture manufacturing equipment.

In addition, qualified property must be purchased and placed in service before the enterprise zone designation expires. The maximum value of property that may be eligible for the enterprise zone sales or use tax credit is \$1 million for individuals and \$20 million for corporations.

Hiring Credit

A business located in an enterprise zone may reduce tax by a percentage of wages paid to qualified employees. A qualified employee must be hired after the area is designated as an enterprise zone and meet certain other criteria. At least 90% of the qualified employee's work must be directly related to a trade or business located in the enterprise zone and at least 50% must be performed inside the enterprise zone. The business may claim up to 50% of the wages paid to a qualified employee as a credit against tax imposed on enterprise zone income. The credit is based on the lesser of the actual hourly wage paid or 150% of the current minimum hourly wage (under special circumstances for the Long Beach enterprise zone, the maximum is 202% of the minimum wage). The amount of the credit must be reduced by any other federal or state jobs tax credits and the taxpayer's deduction for ordinary and necessary trade or business expenses must be reduced by the amount of the hiring credit.

Business Expense Deduction

A business located in an enterprise zone may elect to deduct as a business expense a specified amount of the cost of qualified property purchased for exclusive use in the enterprise zone. The deduction is allowed in the taxable or income year in which the taxpayer places the qualified property in service. The basis of the property must be reduced by the amount of the deduction. The maximum deduction for all qualified property is the lesser of 40% of the cost or the following:

If the property was placed in service:

Months after designation	Maximum deduction
0 to 24	\$40,000
25 to 48	30,000
48 and over	20,000

Net Operating Loss Deduction

A business located in an enterprise zone may elect to carry over 100% of the enterprise zone net operating losses (NOLs) to deduct from enterprise zone income of future years. The election must be made on the original return for the year of the loss. The NOL carryover is determined by computing the business loss that results from business activity in the enterprise zone.

Net Interest Deduction

A deduction from income is allowed for the amount of net interest earned on loans made to a trade or business located in an enterprise zone. Net interest is defined as the full amount of the interest less any direct expenses (e.g., commission paid) incurred in making the loan. The loan must be used solely for business activities within the enterprise zone and the lender may not have equity or other ownership interest in the enterprise zone trade or business.

Employee Wage Credit

Certain disadvantaged individuals are allowed a credit for wages received from an enterprise zone business. Public employees are not eligible for the credit. The amount of the credit is 5% of "qualified wages," defined as wages subject to federal unemployment insurance. For each dollar of income received by the taxpayer in excess of qualified wages, the credit is reduced by nine cents. The credit is not refundable and cannot be carried forward. The amount of the credit is limited to the amount of tax that would be imposed on income from employment in the enterprise zone, computed as though that income represented the taxpayer's entire taxable income.

Apportioning

For businesses operating inside and outside an enterprise zone, the amount of credit or net operating loss deduction that may be claimed is limited by the amount of tax on income attributable to the enterprise zone. Income is first apportioned to California using the same formula as that used by all businesses that operate inside and outside the state (property, payroll, a double-weighted sales factor). This income is further apportioned to the enterprise zone using a two-factor formula based on the property and payroll of the business.